

**An Audit of  
Milwaukee Public Museum, Inc.  
2005 Financial Crisis  
Interim Report**

**June 2005**

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June 10, 2005

To the Honorable Chairman  
of the Board of Supervisors  
of the County of Milwaukee

We have completed an audit of the Milwaukee Public Museum, Inc. 2005 Financial Crisis, Interim Report. This interim report presents an overview of financial management activity and general conclusions regarding factors leading to MPM's current financial crisis. A separate, final report will be issued to address, in greater detail, the trends and financial practices for recent years that lead to MPM's financial position.

A response from the Chairman of the MPM Board of Directors is included as **Exhibit 4**. We appreciate the cooperation extended by the MPM Board and its staff during the audit.

Please refer this report to the Committee on Finance and Audit.

Jerome J. Heer  
Director of Audits

JJH/cah

Attachment

cc: Milwaukee County Board of Supervisors  
Scott Walker, Milwaukee County Executive  
Linda Seemeyer, Director, Department of Administrative Services (DAS)  
Stephen Agostini, Fiscal and Budget Administrator, DAS  
William Domina, Corporation Counsel  
Terrence Cooley, Chief of Staff, County Board Staff  
Steve Cady, Fiscal and Budget Analyst, County Board Staff  
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# **An Audit of Milwaukee Public Museum, Inc. 2005 Financial Crisis Interim Report**

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## Summary

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A May 4, 2005 newspaper story reported a \$4.1 million negative result for operations acknowledged by the Milwaukee Public Museum, Inc. (MPM). News of the fiscal year (FY) 2004 loss was of particular concern to Milwaukee County officials because of recent action to establish a new 20-year lease and management agreement with MPM. On April 15, 2005, the MPM Chief Executive Officer (CEO) announced the departure of the Chief Operating Officer/Chief Financial Officer (COO/CFO), and on June 3rd, the CEO announced his own resignation. This interim audit report addresses questions about the status of MPM at the end of its most recent fiscal year (August 31, 2004) and the financial condition at the time of negotiations for the new agreement. In this interim report, we:

- Assess MPM's governance structure and oversight practices.
- Examine the 'due diligence' procedures used by Milwaukee County during negotiation of the new lease and management agreement.
- Present an overview of financial management activity and make general conclusions regarding factors leading to MPM's current financial crisis.

A separate, final report will be issued to address, in greater detail, the trends and financial practices for recent years that lead to MPM's financial position.

### **MPM Recent Financial Condition**

Based on the most recent unaudited financial statements, MPM had a FY2004 net asset loss of \$5.4 million. This represents a \$1.3 million increase over the \$4.1 million loss of net assets originally reported by MPM in newspaper accounts. As of April 30, 2005, MPM's preliminary financial statements for museum operations only (non-consolidated) indicate a net asset loss of \$2.2 million for the first three quarters of FY2005. Those same financial statements show MPM owes its Endowment Fund \$4,221,274. The investment banking firm of Starshak, Welnhof & Co. was hired in March of this year as 'turnaround consultants' by MPM at the behest of its creditor banks. The firm projected that, on an annualized basis, and excluding restricted gifts, proceeds from special exhibits and depreciation, MPM is losing \$7.2 million from normal operations.

### **Factors Leading to Current Financial Crisis**

In **Section 2** of this report, we present selected key financial trends for MPM from 1999 through 2004. The information is presented from the consolidated financial statements of MPM, Inc., which

includes not only museum operations, but also activity from subsidiary components such as the Friends of the Museum and the Endowment Fund. The trends show that a combination of deficits from core museum operations, aggressive growth financed by long term debt and contributions, coupled with a failure to sustain an adequate stream of new contributions, resulted in the general deterioration of MPM's financial condition. This is reflected in three consecutive years of a 'bottom line' reduction in total net assets, from \$16.1 million in FY2001 to just \$7.5 million in FY2004. The disparate trends continued at an accelerating pace from FY2002 through FY2004, culminating in the financial crisis publicly acknowledged in May 2005.

### **Administrative Structure and Responsibility to Inform**

Minutes of both the MPM Board of Directors and the MPM Audit and Finance Committee meetings contain clues about the deterioration of MPM's financial condition. It does not appear, however, that the severity of the situation was ever disclosed directly by management or probed into by Directors until early in 2005. Further, presentations of any potentially negative financial results were routinely packaged with more optimistic factors to offset the concerns.

The absence of any significant, detailed oversight by Directors may have been compounded by the structure of responsibilities within MPM management. Since January 2003, the same individual has served as both the Chief Operating Officer (COO) and the Chief Financial Officer (CFO). Vesting responsibility for administration, operations and finance in one person was particularly problematic given the broad power to manage MPM's funds. This authority, which included the ability to authorize the sale and disbursement of Endowment Fund assets, was granted by Board action in April 2002, without the benefit of any approval. Based on internal monthly financial statements maintained by MPM fiscal staff, the COO/CFO first accessed Endowment Fund assets to support museum operations in March 2004. As of April 30, 2005, the internal financial statements show the Endowment Fund is virtually depleted, with a balance of approximately \$340,000.

### **Separation Agreement**

The standard employment agreement for MPM administrators has a one-year payout provision, although it should be noted that several of these existing provisions have been modified to 90-day payouts in light of MPM's current financial position. A separate agreement and release was prepared when the COO/CFO ended his employment. This agreement calls for a payout equivalent to about \$28,500. However, there is also a provision that neither party may make any negative or disparaging remarks about the other. This provision could have the effect of hindering full disclosure of issues affecting activities within the museum. We believe that both the one-year payout clause and the restriction on discussion of any facts related to separation are inappropriate

for an organization entrusted with public funds and the operation of a public facility, and we question the motivation for such self-serving clauses.

### **Board Governance and Oversight**

The MPM Board of Directors is comprised of 27 members (see **Exhibit 2**). Given MPM's conditions over the last three and one-half years, we expected to see more discussion about the use of endowment funds, increases in the line of credit, liquidation of investments and losses on operations. We also expected to see Board action concerning budget modifications made by MPM management throughout the year. However, we found no examples of the Board reviewing and formally approving any budget modifications until the aftermath of the current financial crisis. Further, we note that MPM's Audit and Finance Committee meets just twice each year. At one meeting, the committee reviews and acts on the organization's annual budget and conducts other business. The other meeting focuses on a review of the audited financial statements. However, the degree of involvement and oversight provided by a committee that meets only twice a year can be called into question.

### **Milwaukee County Due Diligence**

In 2000, the Milwaukee County Board of Supervisors directed the development of due diligence procedures to be followed prior to entering into ventures with other entities. The due diligence administrative procedures include a checklist of items to consider prior to recommending any joint venture (see **Exhibit 3**). While this list includes key elements such as cash flow projections, operating budget impacts, debt management and financial reporting systems, the checklist does not specifically direct a review of audited financial statements.

The recent negotiation and due diligence for the 20-year agreement with MPM was managed within the County Department of Administrative Services (DAS). The process did not involve a review of prior year audited financial statements because MPM's audited statements for its fiscal year ending August 31, 2004 had not yet been finalized. It is not clear whether MPM offered to provide unaudited statements. In fact, there are indications that the former COO/CFO misled both the MPM Board of Directors and Milwaukee County officials.

Unlike the subject of many due diligence reviews, Milwaukee County has had a 13-year relationship with MPM. It is clear, however, that MPM's financial condition prior to the March 17, 2005 County Board vote on the new agreement was dire. This condition was known, in at least a general sense, to MPM's Board members, managers, bankers, auditors and attorneys. We believe that the failure

to publicly disclose MPM's condition prior to County Board adoption of the new agreement was a violation of the public trust.

## **Conclusions**

There has been much interest in determining the party or parties responsible for MPM's current financial problems. Ultimate responsibility for MPM rests with its Board of Directors. Day-to-day administration is clearly the responsibility of the CEO. In this case, the Board also placed significant reliance on the COO/CFO.

According to the COO/CFO, he was instructed to communicate with the MPM Board through the CEO. According to the CEO, the COO/CFO was free to present any information that he believed was appropriate to the Board and its Committees. It is especially disturbing that the COO/CFO did not, in clear and unambiguous terms, communicate to the MPM Board the steadily declining, and ultimately dire, financial condition of MPM.

It is a matter of dispute whether the severity of MPM's financial situation was clearly communicated by the COO/CFO to the CEO. In either event, the COO/CFO knew, or should have known, as early as the March of 2004, when he first 'borrowed' Endowment Fund resources to support museum operations, that MPM was in a seriously deteriorating financial state. Further, the CEO knew, or should have known, the same reality. It was at this time that both these individuals, along with the MPM Board Secretary/Treasurer, signed a security agreement with a creditor bank that committed "...all inventory...all revenues, rents, issues, profits, income, and receipts derived in any fashion from all sources..." as collateral for credit extended. Clearly, these individuals collectively failed to inform Milwaukee County of MPM's fragile condition throughout negotiations for a long-term lease and management agreement.

Our review indicates that a climate of continuous growth was promoted by MPM administrators and embraced by its Board of Directors, but that fundraising was inadequate to sustain such ambitious growth. The result is an organization that saw its financial position decline from one of relative strength in 2001 to near insolvency in 2005. Restoration of fiscal stability will not be easy, nor will it be accomplished quickly.

We would like to acknowledge the cooperation of MPM staff during the course of our audit. A management response from the MPM Board of Directors is attached as **Exhibit 4**.

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## Background

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The Milwaukee Public Museum has been in operation since 1882. In 1976, responsibility for the museum was moved from the City of Milwaukee to Milwaukee County. The County managed the museum until 1992, when operation was transferred to Milwaukee Public Museum, Inc. (MPM). All artifacts and the museum facility have been, and continue to be, the property of Milwaukee County. The Department of Audit monitored the transition of the museum from a public to a private enterprise until December 2001. Since its departure from County administration, MPM has established formal affiliations with subsidiary interests whose activities are included in consolidated financial statements of the core museum operations. These affiliations include Friends of the Milwaukee Public Museum, Inc. (FOM), the Endowment Fund, and the Tirimbina Rainforest Center. On nearly every measure, the transfer was determined, at that time, to be a success, particularly regarding MPM's ability to raise private funds. For instance, Milwaukee County's share of total revenues for MPM decreased from about 59% in 1991 to less than 23% in 2001. Private donations increased from \$607,00 in 1992 to \$5.7 million in 2001.

On May 3, 2005, MPM notified Milwaukee County officials that a newspaper story about MPM finances would be published the next day. In the story, MPM acknowledged a \$4.1 million negative result for its 2004 operations. News of the 2004 loss was of particular concern to County officials because of recent action to establish a new 20-year lease and management agreement with MPM. The new agreement substantially altered the original 1992 agreement under which the private entity has managed the operations of the museum. A base funding level of \$3.178 million was set for the first 10 years. Further, Milwaukee County participation in funding of, and guarantees of, capital projects and debt were redefined in a way that would put the County in a position to guarantee future debt. Although the County Board approved the new agreement on March 17, 2005, final documents had not yet been executed when MPM's financial problems were publicly acknowledged. County officials were disturbed to find that, within two months after negotiations, MPM was in danger of not making payroll payments to its employees.

On April 15, 2005, the MPM Chief Executive Officer (CEO) announced the departure of the Chief Operating Officer/Chief Financial Officer (COO/CFO). Both the CEO and the COO/CFO stated that a 2005 departure had been planned for several months. On June 3rd, the CEO announced his resignation.



In response to concerns about MPM's newly-disclosed financial condition, the new lease and management agreement was rescinded pending further review, a County management team was appointed to address the current challenges, and an audit was called for.

Our audit was designed to address questions about the status of MPM at the end of its most recent fiscal year (August 31, 2004) and the financial condition at the time of negotiations for the new agreement. Included in this interim report is an assessment of MPM's governance structure and oversight practices. We also examine the 'due diligence' procedures used by Milwaukee County during negotiation of the new agreement. This interim report also presents an overview of financial management activity and general conclusions regarding factors leading to MPM's current financial crisis. A separate, final report will be issued to address, in greater detail, the trends and financial practices for recent years that lead to MPM's financial position. The final report will examine MPM special exhibits, retail sales, rentals, the IMAX Theater and other key revenue and expenses that are not detailed in this interim report.

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## Section 1: MPM's Recent Financial Condition

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**Based on its most recent unaudited financial statements, MPM had a FY2004 net asset loss of \$5.4 million.**

### **2004 Financial Condition**

There have been different interpretations of MPM's financial condition at the end of its fiscal year ending August 31, 2004 (FY2004). Discussions have centered primarily on MPM's financial performance relative to its operating deficit and the change in its net assets. Based on its most recent unaudited financial statements, MPM had a FY2004 net asset loss of \$5.4 million. This represents a \$1.3 million increase over the \$4.1 million loss of net assets originally reported in newspaper accounts. Given the timing of the negotiations on a new 20-year agreement, the discussion and disclosure of MPM's financial condition at fiscal year-end 2004 is of critical interest to Milwaukee County decision makers. Further, identifying the financial strength of MPM at the end of August 2004 is essential to understanding its inability to make payroll payments in mid-May 2005.

### Audited Financial Statements

Analysis of the year-end FY2004 financial status of MPM has been complicated by the manner in which the reporting of audited financial statements has taken place. A November 2004 draft of the audited figures prepared by the commercial audit firm was provided to the MPM Board of Directors as early as December 2004. MPM records also include a 'PowerPoint' briefing on the auditors' conclusions that was presented to the MPM Audit and Finance Committee at a meeting on January 28, 2005. Included in that presentation were the following items:

- *The Museum experienced significant increases in operational revenues including admissions, restaurant, facility and retail services due to the increased interest in the Museum that the Quest exhibit generated.*
- *Program and Exhibit expense increased proportionally to their related revenues.*

- *The reversion of the pension obligation to Milwaukee County as a result of the new agreement generated a \$2.1 million non-operating gain.*
- *The Museum has experienced net losses for three consecutive years.*

The auditors also noted that the financial statement audit would be issued upon execution of a finalized agreement with Milwaukee County.

However, the assumed \$2.1 million shift of pension liabilities for former Milwaukee County employees back to Milwaukee County was without foundation. While this item was indeed raised in the negotiations for a new agreement, the likelihood of incorporating the provision was never strong. Regardless, according to the former MPM Chief Financial Officer, the \$2.1 million reduction in liabilities was carried on MPM's draft financial statements until March 18, 2005, the day after the County Board vote on the new agreement.

Although a revised draft of the audited financial statements was provided by the commercial audit firm to MPM on April 5, 2005, the final report has not been issued as of June 10, 2005, 283 days after the end of MPM's fiscal year. The audit firm initially declined our request to discuss the 2004 audit, as well as to review the draft and associated work papers, until the final report is issued. A subsequent offer to meet with us was conveyed through MPM's attorney. We found the limitations placed on a prospective meeting to be unacceptable. The firm did not provide an estimate of how long it would take to complete the report.

**As of April 30, 2005, MPM's preliminary financial statements for museum operations only (non-consolidated) indicate a net asset loss of \$2.2 million for the first three quarters of FY2005.**

#### **2005 Financial Condition**

As of April 30, 2005, MPM's preliminary financial statements for museum operations only (non-consolidated) indicate a net asset loss of \$2.2 million for the first three quarters of FY2005. Those same financial statements show MPM owes its Endowment Fund

\$4,221,274, including approximately \$800,000 in permanently restricted funds. The investment banking firm of Starshak, Welnhofner & Co. was hired in March of this year as 'turnaround consultants' by MPM at the behest of its creditor banks. The firm projected that, on an annualized basis, and excluding restricted gifts, proceeds from special exhibits and depreciation, MPM is losing \$7.2 million from normal operations. Future success of MPM will hinge on its ability to achieve a 'break-even' budget, significantly improve fundraising, and devise a debt management plan that is accepted by MPM's banks and Milwaukee County.

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## Section 2: Factors Leading to Current Financial Crisis

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MPM has pointed to a number of factors that have contributed to its serious financial problems. Many of these factors reflect recent events, such as the reconstruction of the Marquette Interchange, a reduced level of attendance and increased health care costs for employees. Other factors that were arguably more within the control of MPM include a long delay in launching a major capital campaign, growth in programs beyond a level that could be sustained with the existing revenue base, and a general decline in grant funds, donations and contributions.

**We have selected key financial indicators to present an overview of the general financial health of MPM, beginning in 1999.**

### **Key Financial Trends**

We have selected key financial indicators to present an overview of the general financial health of MPM, beginning in 1999. We have selected 1999 as a beginning point because, as noted in the **Background** section of this report, there was a consensus that MPM had successfully transitioned from a public institution to a public/private partnership. In addition, 1999 was the first year of MPM's last major capital campaign, the 21<sup>st</sup> Century Fund. The analysis presented in this interim report will focus on an overview of these general financial trends; some of the underlying causes of those trends will be more thoroughly examined in a final audit report, to be completed at a later date.

To understand the significance of these selected financial trends, it is important to understand several concepts and definitions:

- **Cash and Cash Equivalents.** Cash and other highly liquid investments with maturities of three months or less. This provides insight into MPM's ability to meet cash outlay requirements, such a payroll and vendor invoices.
- **Contributions and Memberships.** Includes revenue raised from memberships to the Friends of the Museum and contributions over and above the two basic levels of membership. All proceeds are classified as unrestricted and can be used to support all operations and programs.

- **Net Revenue & Support from Operations.** Funds available after revenues (includes admissions, IMAX, retail and restaurant sales), unrestricted contributions and grants are netted against operating expenses. These funds are unrestricted and can be used for any purpose.
- **Line of Credit.** Funds normally borrowed for a short period of time (under a year) to cover cash shortages.
- **Property and Equipment.** Major expenditures for construction, building additions and improvements, as well as furnishings and equipment.
- **Long Term Liability.** Primarily the outstanding debt obligations from the issuance of bonds.
- **Unrestricted Assets.** Funds and other gifts for which no specific restrictions have been placed upon their use. Indicates the availability of funds available to support any aspect of the museum's operations.
- **Temporarily Restricted Assets.** The balance of funds, investment proceeds and other gifts, the use of which has been specifically restricted for certain purposes. For instance, a donation may be made specifically for use in supporting the museum's Butterfly Exhibit. When the purpose restriction is met, temporarily restricted assets are reclassified as 'unrestricted,' and they may be counted as revenue towards MPM's operating 'bottom line.' Indicates whether there are funds available to complete projects that are in progress or to start projects in the works.
- **Temporarily Restricted Contributions.** A subset of temporarily restricted assets, contributions constitute the funds and other gifts donated in the particular year they were pledged that have specific designations. This subset does not include certain items, such as investment proceeds, contained in the category of temporarily restricted assets. Indicates the level of fund raising that has occurred in any given year.
- **Increase/Decrease in Total Net Assets.** This is what is often referred to as the 'bottom line,' the change in the organization's total assets minus total liabilities. The level of total net assets indicates the level of resources available to help meet short and long term obligations.

**Table 1** shows selected key financial trends for MPM from 1999 through 2004. The information is presented from the consolidated financial statements of MPM, Inc., which includes not only museum operations, but also activity from subsidiary

components such as the Friends of the Museum and the Endowment Fund.

**Table 1**  
**MPM, Inc.**  
**Selected Financial Indicators**  
**1999—2004**  
**(in millions)**

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Cash & Cash Equivalents	\$5.4	\$5.1	\$5.7	\$2.6	\$0.6	\$0.5
Contributions & Membership	2.8	2.7	3.3	3.5	4.4	3.0
Net Revenue & Support	(0.3)	0.2	0.2	(1.0)	2.1	(2.8)
Line of Credit	0.3	0.5	0.7	1.0	1.5	2.3
Property & Equipment	10.5	20.3	23.8	26.6	28.3	29.7
Long Term Liability	14.1	18.0	17.1	17.9	17.6	17.9
Temporarily Restricted Assets	9.7	13.2	14.6	15.2	3.7	1.0
Temporarily Restricted Contributions	6.6	3.9	2.8	1.7	1.4	0.5
Total Net Assets	10.1	14.2	16.1	14.3	12.8	7.5
Inc/Dec Total Net Assets	5.4	4.1	1.9	(1.8)	(1.5)	(5.4)
Percent Change Total Net Assets	N/A	41%	13%	-11%	-10%	-42%

Source: MPM audited financial statements (1999—2003); unaudited financial statements (2004).

Based on our review of year-end audited financial statements for 1999—2003, unaudited financial statements for 2004 and discussions with MPM fiscal staff, we make the following observations of MPM's general financial health.

- **Cash and Cash Equivalents** at year-end shows a precipitous decline since fiscal year-end 2001, from \$5.7 million to just \$500,000 at fiscal year-end 2004.
- **Contributions and Memberships** reflect a substantial drop from FY2003, at \$4.4 million, to FY2004, at \$3.0 million. This is of particular concern given MPM's record-breaking attendance from the Quest for Immortality special exhibit in 2004.
- **Net Revenue and Support**, which is a key indicator to show funds generated from operations, shows a precarious margin of profitability from FY1999—FY2001, but reflects a drain on resources in two out of the next three years. The one exception, FY2003, is significantly bolstered by a change in accounting rules for MPM. The change freed up approximately \$8.1 million of previously restricted funds (this is a major portion of the reduction of **Temporarily Restricted Assets**) and provided approximately \$4 million that had the

**An accounting change in FY2003 provided approximately \$4 million that had the effect of masking mounting losses from core museum operations.**

effect of masking mounting losses from core museum operations.

**Private donations obtained by MPM show a dramatic decline over the period, from its peak in FY1999 of \$6.6 million, to just \$500,000 in FY2004.**

**The general deterioration of MPM's financial condition is reflected in three consecutive years of a 'bottom line' reduction in Total Net Assets, from \$16.1 million in FY2001 to just \$7.5 million in FY2004.**

- **Line of Credit** steadily increases over the period, from \$300,000 in FY1999 to \$2.3 million in FY2004. (As of April 30, 2005 MPM's line of credit has increased to \$3.5 million.) This reflects the increasing reliance of MPM on outside creditors to meet basic cash flow requirements.
- **Property and Equipment** increased from \$10.5 million in FY1999 to \$29.7 million in FY2004. This increase reflects the dramatic growth in physical assets, such as building improvements and special exhibits, acquired by MPM during the period. Examples of these acquisitions include the construction of the IMAX Theater, the Butterfly exhibit, and the Bugs Alive exhibit. Much of this growth was financed with a portion of MPM's **Long Term Liability**, which has remained relatively steady during this period, in the \$17-\$18 million range, along with restricted contributions.
- **Temporarily Restricted Contributions**, representing the extent of private donations obtained by MPM, show a dramatic decline over the period, from its peak in FY1999 of \$6.6 million, to just \$500,000 in FY2004. A steady stream of contributions was initially intended to pay down long-term debt and to establish a permanent endowment from which to support special exhibits and operations. However, this precipitous decline in contributions, in concert with MPM's aggressive acquisition of Property and Equipment, has left the museum unable to meet the primary goal of paying down long-term debt, let alone establish a permanent endowment.
- The combination of deficits from core museum operations, aggressive growth financed by long term debt and contributions, failure to sustain an adequate stream of new contributions, resulted in the general deterioration of MPM's financial condition. This is reflected in three consecutive years of a 'bottom line' reduction in **Total Net Assets**, from \$16.1 million in FY2001 to just \$7.5 million in FY2004.
- The **Increase/Decrease in Total Net Assets** trend shows that the deterioration has accelerated dramatically in FY2004. In FY2002, MPM experienced a loss of \$1.8 million; in FY2003, it lost another \$1.5 million; in FY2004, the loss mounted to \$5.4 million.

Viewing the financial information for MPM only, isolated from the effects of consolidating financial statements with its subsidiary components, shows even more dramatically how core museum operations were running deficits and creating a drain on overall assets. For instance, the decrease in total net assets from the



**A distinct trend of declining contributions at the same time that MPM was pursuing a strategy of growth, yet sustaining operational losses, brought MPM to a crossroads at fiscal year-end 2002.**

museum alone in FY2004 was \$6.3 million, as opposed to the \$5.4 million consolidated financial statements figure. Further, the consolidated statements have the effect of masking the fact that MPM, as of August 31, 2004, had borrowed \$761,000 from the Endowment Fund (and currently owes the Endowment Fund \$4.2 million).

A distinct trend of declining contributions at the same time that MPM was pursuing a strategy of growth, yet sustaining operational losses, brought MPM to a crossroads at fiscal year-end 2002. The disparate trends continued at an accelerating pace through FY2004, culminating in the financial crisis publicly acknowledged in May 2005.

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## Section 3: MPM Administration

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**Presentations of any potentially negative financial results were routinely packaged with more optimistic factors to offset the concerns.**

### **Administrative Structure and Responsibility to Inform**

Minutes of both the MPM Board of Directors and the Audit and Finance Committee meetings contain clues about the deterioration of MPM's financial condition. It does not appear, however, that the severity of the situation was ever disclosed directly by management or probed into by Directors until early in 2005. Further, presentations of any potentially negative financial results were routinely packaged with more optimistic factors to offset the concerns. Specific details on successful ventures appeared to be more prevalent than details on operations that were not performing well. The minutes also reflect a focus on growth and expansion of MPM's programs and operations by both management and the Board.

The absence of any significant, detailed oversight by Directors may have been compounded by the structure of responsibilities within MPM management. Since January 2003, the same individual has served as both the Chief Operating Officer (COO) and the Chief Financial Officer (COO/CFO). When the COO job description was finalized later in 2003, it included reporting lines to both the President (CEO) and to the Board of Directors. In addition to financial duties, as COO, this individual was responsible for admission, security, facilities, human resources, technology and business development.

The COO title was initially established as an 'acting' position pending recruitment of a new President/CEO. As a result, from November 2002 until November 2003, this same person also functioned as the Chief Executive Officer (CEO). Vesting responsibility and control of both operations and finance in one employee can have the effect of minimizing balance and perspective that can be healthy in an organization. For example, as COO/CFO, a critical analysis of a business venture may be

difficult if the same person has responsibility for the venture. Adding the duties of COO during 2003 had the more serious effect of limiting the internal division of responsibilities that can function, to some degree, as a form of checks and balances.

**Vesting responsibility for administration, operations and finance in one person was particularly problematic given the broad power to manage MPM's funds.**

Finally, vesting responsibility for administration, operations and finance in one person was particularly problematic given the broad power to manage MPM's funds. Such power included the ability to authorize, without Board or Committee approval, use of both restricted and unrestricted funds maintained under the auspices of the Endowment Fund. This authority, which included the ability to authorize the sale and disbursement of Endowment Fund assets, was granted by Board action in April 2002, without the benefit of any approval. Based on internal monthly financial statements maintained by MPM fiscal staff, the COO/CFO first accessed Endowment Fund assets to support museum operations in March 2004. As of April 30, 2005, the internal financial statements show the Endowment Fund is virtually depleted, with a balance of approximately \$340,000. (This includes use of approximately \$800,000 in permanently restricted funds.)

**As of April 30, 2005, the internal financial statements show the Endowment Fund is virtually depleted, with a balance of approximately \$340,000.**

According to an Executive Committee member, the most recent CEO, during his first year, had suggested aggregating funds more clearly and moving away from the COO/CFO structure. The CEO's suggestions were rejected.

Hands-on management of detailed financial activities by the current President/CEO was not evident in internal correspondence until February 19, 2005. At that point, concerns about cash flow resulted in a plan by the CEO to bring operations into fiscal balance. One month later, on March 13, 2005 a recent payroll overdraft at the bank prompted a freeze in expenditures, all credit cards were collected, a "workout" consultant was pursued at the bank's urging, accounts payable were put under aggressive management and the Executive

Committee recommended the use of endowment funds to cover the overdraft. It was also noted that the new agreement with Milwaukee County was essential to MPM's survival. Finally, the plan also included the need for the County to advance the payment under the current agreement by two days so MPM could make a \$1.1 million debt payment.

When the County Department of Administrative Services questioned whether this was a sign of cash flow problems, the COO/CFO stated that it was a timing issue because the bank was being inflexible. It is clear now that the real motivation was that MPM did not have the cash to make the payment.

**The fact that these funds were not available is a clear example of MPM's inappropriate use of committed funds to cover mounting operational deficits.**

MPM's inability to make this payment is particularly troublesome because \$1 million of the \$1.1 million payment should have been available from a 1999 gift of \$3 million, spread over four years, specifically earmarked by a bond agreement for the payment of bonds associated with the Butterfly exhibit. The fact that these funds were not available is a clear example of MPM's inappropriate use of committed funds to cover mounting operational deficits.

During this general time MPM was also working out payment plans with professional service vendors, including its attorney and audit firm. This type of activity in reaction to cash flow problems has occurred at MPM on several occasions in recent years, but was clearly elevated in early 2005. Under normal conditions, a line of credit and an aggressive expenditure reduction plan would be used to manage through such challenges. Neither were enough to stave off the need to juggle vendor payments. Bank officials were also actively engaged in determining the status of MPM's finances. One month later, on April 15, 2005, the CEO announced the departure of the COO/CFO and of the Vice President of Organization and Enterprise Development.

**The standard employment contract for administrators has a one-year payout provision.**

### **Separation Agreements**

MPM administrators have a standard contract that contains provisions for separation from employment. The standard agreement has a one-year payout provision, although it should be noted that several of these existing provisions have been modified to 90-day payouts in light of MPM's current financial position. A separate agreement and release was prepared when the COO/CFO ended his employment. This agreement calls for a payout equivalent to about \$28,500. However, there is also a provision that neither party may make any negative or disparaging remarks about the other. This provision could have the effect of hindering full disclosure of issues affecting activities within the museum. We believe that both the one-year payout clause and the restriction on discussion of any facts related to separation are inappropriate for an organization entrusted with public funds and the operation of a public facility, and we question the motivation for such self-serving clauses.

### **Reporting to Milwaukee County**

The current agreement between Milwaukee County and MPM also requires that annual audits, annual budgets and quarterly financials be filed with the County Executive and the County Clerk. According to these two offices, none of the required filings have been made in at least the last three years. If a new agreement is to be drafted, language should be included that requires these reports to be filed with the Department of Audit and the Department of Administrative Services.

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## Section 4: MPM Governance and Oversight

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### MPM Board of Directors

The MPM Board of Directors is comprised of 27 members (see **Exhibit 2**). The County Executive appoints five members and the County Board Chairman appoints four, with the remaining 18 members elected by the MPM Board. Committees of the MPM Board include: Executive, Audit and Finance, Development, Education Programming, Endowment, Human Resources, Government Affairs and Nominating. The Board has no term limits and eight of the members came on the Board before 2000. Prior to 2002, the Board was comprised of 15 appointments by Milwaukee County instead of the current nine County-appointed members. The reduction was made in the context of Milwaukee County’s share of total revenues decreasing from 59% in 1991 to less than 23% in 2001.

We reviewed attendance rates for the full Board meetings and for several key committees.

We reviewed attendance rates for the full Board meetings and for several key committees. **Table 3** shows the results for the full Board.

Table 3 MPM Board of Directors Attendance 2002-2004		
<u>Year</u>	<u>Number of Meetings</u>	<u>% of Board Members Present</u>
2002	6	55%
2003	7	65%
2004	5	76%
Source: MPM Board meeting minutes.		

As **Table 3** shows, even though the full Board of Directors meets less than monthly, member absences are common.

**It was not unusual for a projected shortfall in revenues to be addressed with a plan to adjust expenses to resolve a negative variance from the annual budget.**

Each Board meeting agenda includes a discussion of the financial status of MPM. Typically, a review of key statistics highlights attendance and other revenue indicators. Based on our review of Board materials, it was not unusual for a projected shortfall in revenues to be addressed with a plan to adjust expenses to resolve a negative variance from the annual budget. As early as January 2002, for example, it was reported that a \$300,000 revenue shortfall would be addressed with expense reductions. A similar discussion took place at the Board meeting in April 2002. A decrease in earned revenue was also highlighted at the June 2002 meeting when the 2003 budget was adopted. The February 2003 Board meeting included a discussion of a \$1 million expenditure reduction during the year to deal with several one-time costs. Some concern about risk was also expressed at the June 2003 meeting when the 2004 budget was adopted based on what the COO/CFO called MPM's "stable growth model." Other than these discussions, financial reports generally focused on the growth in MPM operations referenced in the 2004 budget.

Board Members receive a detailed packet outlining the key items to be discussed at their meetings. According to the packet for the February 19, 2004 meeting, the following financial overview for FY2003 was presented by the COO/CFO:

- *9<sup>th</sup> straight year with a balanced operating budget.*
- *Total revenues exceeded \$21 million.*
- *5<sup>th</sup> straight year of increases of more than 10 percent total revenue each year.*
- *Private support was at \$4.3 million-reflecting a 10 percent increase in Annual Campaign & Membership to \$3.7 million and \$600,000 in Special Exhibit Funding. (Membership alone increased 11 percent from the prior year to over \$1.25 million.)*
- *Grants revenue increased and operating revenues continued its sustained growth pattern.*

- *IMAX attendance increased 12 percent.*
- *Retail exceeded \$2 million for the first time.*
- *Admissions set a record at just short of 1.1 million people--an increase of 7.4 percent over the previous year.*
- *Hospitality hosted a record 291 events.*
- *Expenses increased 5 percent--reflecting commitments to Curatorial, Exhibits, Programs, and Grants. Facilities expenses decreased for the first time in five years.*
- *Administrative costs increased due to increased costs for pension and health care.*
- *Public funding (Milwaukee County) was down 5 percent.*
- *Through the use of an Interest Based Bargaining process, MPM entered into new contracts with its labor unions, providing greater incentives for performance and introducing more sweeping merit based systems, which benefit both the staff and the museum.*
- *Total operating surplus was \$1.4 million, with non-operating revenues at \$537,000.*

In light of this generally positive information, the April 2004 Board meeting included a discussion of the acquisition of the Discovery World property and a resolution related to the transfer of sole ownership of a Costa Rican rainforest preserve (Tirimina) to MPM.

**The financial report on the first six months of the 2004 fiscal year presented a number of concerns.**

At that same meeting, the financial report on the first six months of the 2004 fiscal year presented a number of concerns. At mid-year, MPM was experiencing a loss that was \$800,000 more than planned. Revenue shortfalls were attributed primarily to weaker results from an annual campaign and memberships. An aggressive expense reduction plan was implemented. The September 2004 Board packet identified a level of cash flow that was \$2 million lower than expected and noted that this was due to operations, not investment or debt activity. The impact on bank loans was mentioned. It was pointed out that a delay in the capital campaign "has put further pressure on the erosion of



cash needed for operations” and that management discussion and attention was needed.

**We expected to see more discussion about the use of endowment funds, increases in the line of credit, liquidation of investments and losses on operations.**

Given MPM’s conditions over the last three and one-half years, we expected to see more discussion about the use of endowment funds, increases in the line of credit, liquidation of investments and losses on operations. We also expected to see Board action concerning budget modifications made by MPM management throughout the year. However, we found no examples of the Board reviewing and formally approving any budget modifications until the aftermath of the current financial crisis. For example, after approval of the FY2005 budget, a reduction of \$1 million was made by the Chief Executive Officer based on revised fund development estimates. With less than three months remaining in the fiscal year, this change has not been reported to the MPM Board.

#### **Executive Committee**

**Table 4** shows a regular pattern of 70%—80% attendance at Executive Committee meetings from 2002—2004.

<b>Table 4 MPM Executive Committee Attendance 2002-2004</b>		
<b><u>Year</u></b>	<b><u>Number of Meetings</u></b>	<b><u>% of Board Members Present</u></b>
2002	4	71%
2003	6	88%
2004	5	77%
Source: MPM Committee meeting minutes.		

Like many non-profit organizations, MPM relies on its Executive Committee to provide more detailed direction of day-to-day operations than can normally be accomplished in meetings of a board with 27 members. Records of the Executive Committee’s meetings for the last three years contain sporadic discussion of

**In February 2005, a serious message was sent to the full MPM Board regarding the condition of MPM's finances.**

MPM's cash position. Discussions focused on a variety of key aspects of MPM operations including special exhibits, the new agreement with Milwaukee County, acquisition of the Discovery World facility, consolidation of Tirimbina into MPM, the search for a new CEO and the receipt of grants. It was not until January 2005 that the Executive Committee meeting contained a discussion of a 90-day freeze on expenses to address cash flow issues. In February 2005, a serious message was sent to the full MPM Board regarding the condition of MPM's finances. Concerns about liquidity were included in that presentation. This was the first record of a clear concern about liquidity since the January 2004 presentation by the previous audit firm. The Executive Committee met with the CEO and the COO/CFO on March 11, 2005 to discuss how MPM had gotten into the fiscal crisis.

#### **Audit and Finance Committee**

MPM's Audit and Finance Committee meets just twice each year. At one meeting, the committee reviews and acts on the organization's annual budget and conducts other business. The other meeting focuses on a review of the audited financial statements. **Table 5** shows attendance for Audit and Finance Committee meetings for the period 2002—2004.

<b>Table 5</b> <b>MPM Audit &amp; Finance Committee Attendance</b> <b>2002-2004</b>		
<b><u>Year</u></b>	<b><u>Number of Meetings</u></b>	<b><u>% of Board Members Present</u></b>
2002	1	60%
2003	2	88%
2004	2	100%

Source: MPM Committee meeting minutes.

**The degree of involvement and oversight provided by a committee that meets only twice a year can be called into question.**

**Table 5** shows that attendance of Audit and Finance Committee members is generally better than the full Board of Directors. However, the degree of involvement and oversight provided by a committee that meets only twice a year can be called into question.

Minutes of MPM Audit and Finance Committee meetings from 2002 through 2004 indicate that the committee reviewed annual audits. In addition, presentations by the external audit firm show that key provisions of the audit were discussed. An example of one such discussion is a change in the accounting treatment of restricted assets (see page 12). At each meeting when the annual audit was presented, the external auditors also spent time meeting privately with the committee, without MPM employees in the session. This is intended to allow for a free flow of any concerns regarding management employees.

On January 23, 2004, the committee was briefed on the 2003 financial audit by MPM's previous outside audit firm. Two observations by the auditors provide early signals of concerns. First, the auditors noted that MPM had experienced net losses for two consecutive years. Second, the firm stated the "liquidity issues and cash flow management has required management's attention."

Within two months of this discussion, MPM's banks were in the process of placing a general lien on all of MPM's assets. There are no indications that this information was shared with the committee. In fact, the Audit and Finance Committee did not hold another meeting until June 2004 and there is no mention of fiscal concerns in the record of that meeting.

## Endowment Committee

**Table 6** shows attendance for the Endowment Committee meetings for the period 2002—2004.

<b>Table 6</b> <b>MPM Endowment Committee Attendance</b> <b>2002-2004</b>		
<b><u>Year</u></b>	<b><u>Number of Meetings</u></b>	<b><u>% of Board Members Present</u></b>
2002	1	83%
2003	2	64%
2004	3	61%
Source: MPM Committee meeting minutes.		

Similar to the Audit and Finance Committee, **Table 5** shows a relatively few number of meetings held annually by the Endowment Committee. Attendance at Endowment Committee meetings is somewhat sparse, averaging less than two-thirds membership present in both 2003 and 2004.

**According to a March 2001 memo by a former CEO, the 21<sup>st</sup> Century Fund had a goal of \$16 million.**

MPM is supported by a number of funds that have been established for both restricted and unrestricted use. One of the most significant resources is the 21<sup>st</sup> Century Fund. According to a March 2001 memo by a former CEO, the fund had a goal of \$16 million. The purpose of the fund is to use undesignated contributions for paying yearly bond payments and to eventually match the entire debt amount. An additional goal is to increase the level of endowments to cover operational costs as a result of expansion and to provide general budget support. It is clear that the primary intended use of the fund is to address debt. Use for expansion and operations is secondary. As of March 2001, the fund had a balance of \$8.3 million and was expected to grow to \$13.5 million by mid-2004.

The committee is also responsible for overseeing a policy that called for an annual 3% disbursement of endowment funds to

MPM for operations, increased to 5% after there are sufficient funds to cover all bond debt.

Minutes of Endowment Committee meetings reflect a focus to establishing investment policies related to the portfolio blend, management of funds, fees charged to the fund and distribution of income generated by investments. A number of decisions, however, proved to be problematic.

We have already mentioned the decision to place control of the funds in the hands of one individual (see p. 16). We are also concerned that, at the April 2001 meeting, the committee agreed to recommend that the Board commingle the 21<sup>st</sup> Century Fund with the Endowment Fund. While it may be appropriate to pool funds for the purpose of portfolio management, a detailed accounting of the separate fund balances is essential to ensure accountability to donors.

It is interesting to note that the June 2004 minutes contain a discussion about MPM shifting excess special exhibit funds into the endowment. This may give the impression that funds were being generated out of operations that could be placed into the Endowment Fund. However, the September 2004 minutes include a reference to MPM's cash flow problems, a clear indication that no such excess funds from operations were generated.

**A January 28, 2005 meeting of the committee raises a significant concern about the level of disclosure and oversight related to the endowment.**

A January 28, 2005 meeting of the committee raises a significant concern about the level of disclosure and oversight related to the endowment. Outside investment advisors reported on a total portfolio market value of \$6.4 million and distributed a percentage breakdown of the funds. However, the document shared with the committee was a **December 2002** summary—in other words, the committee was briefed on two-year old data. The actual portfolio, as of **December 2004**, was approximately \$2.5 million, or \$3.9 million less than reported to the committee.

MPM's financial staff did not point out the error to the committee. Failure to point out this serious error is an indication that staff was either not diligent in their service to the committee or they did not wish the actual portfolio balance to be known.

Other matters discussed at the January 28, 2005 meeting included a \$1.4 million withdrawal that was returned to the endowment fund, the need for a capital campaign, the purchase of Discovery World, the new lease with Milwaukee County and the need for growth in the endowment fund. There was also a discussion of the need to address liquidity and working capital needs.

The Endowment Committee's concerns were to be addressed in MPM's 2005 Operating Plan. The plan includes groundwork for a two-year strategy to position donors, create a statement of need, conduct a facility study and develop a financial pro-forma. Ironically, the campaign was to begin this summer.

### **Public Meetings**

According to the agreement between Milwaukee County and MPM, all meetings of MPM must comply with the Wisconsin Open Meetings Law. We noted several occasions recently where agendas and descriptions of closed sessions were too vague to evidence compliance with this law. In several instances, for example, Executive Committee agendas and minutes reflect only that a closed session meeting was held. No topic of discussion is provided, as required by law. While the events of the last month have prompted extraordinary efforts on the part of Directors and staff to coordinate meetings, future meetings should be conducted in a manner that more clearly complies with open meetings requirements.

**We noted several occasions recently where agendas and descriptions of closed sessions were too vague to evidence compliance with the Wisconsin Open Meetings Law.**

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## Section 5: Milwaukee County Due Diligence

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In 2000, the Milwaukee County Board of Supervisors directed the development of due diligence procedures to be followed prior to entering into ventures with other entities. The due diligence administrative procedures include a checklist of items to consider prior to recommending any joint venture (see **Exhibit 3**). While this list includes key elements such as cash flow projections, operating budget impacts, debt management and financial reporting systems, the checklist does not specifically direct a review of audited financial statements. Further, it was not until April 6, 2005 that the checklist was modified to include a letter of full disclosure and cooperation by those seeking to enter into an arrangement with Milwaukee County. The addition of this item to the due diligence checklist had been approved by the County Board in July 2004.

Responsibility for completing a due diligence has been assigned to various County departments depending on the nature of the venture. Occasionally, the operating department involved in the initiative had taken the lead. More typically, this responsibility has been assigned to the Department of Administrative Services (DAS). Within DAS, the details of the project have dictated whether the team includes budget staff, accounting staff or both.

**The recent negotiation and due diligence for the 20-year agreement with MPM was managed within DAS.**

The recent negotiation and due diligence for the 20-year agreement with MPM was managed within DAS. Accounting staff was not involved as part of the MPM agreement review team. Further, the process did not involve a review of prior year audited financial statements because MPM's audited statements for its fiscal year ending August 31, 2004 had not yet been finalized. (As of June 10, 2005, the FY2004 audit has not been issued.) The final audit report was being held up pending approval of the new 20-year agreement. In hindsight, it appears that MPM's auditors viewed the agreement as essential in

alleviating reservations about MPM's ability to function as a going concern. It is not clear whether MPM offered to provide unaudited statements. If DAS had obtained draft or final audited statements, MPM's year-end 2004 financial condition would have been known prior to County Board action on the new agreement.

**Unlike the subject of many due diligence reviews, Milwaukee County has had a 13-year relationship with MPM.**

Unlike the subject of many due diligence reviews, Milwaukee County has had a 13-year relationship with MPM. Although MPM was operating under a renewable agreement with Milwaukee County, the new arrangement would have provided a more stable annual funding level than provided under the current approach. Further, the new agreement would place Milwaukee County in a position of having a 'moral obligation' to support future debt. The debt obligations would be subject to further due diligence, but MPM would clearly have benefited from a commitment to the new 20-year venture. In exchange, MPM would have shared in funding building improvement. This, along with discussion of purchasing a lot to the west of the museum building and expanding retail operations to General Mitchell International Airport, conveyed a strong sense of financial stability.

According to the DAS Fiscal and Budget Administrator, MPM officials, on several occasions throughout the lease and management agreement negotiation process, assured the County that MPM finances were sound.

**There are indications that the former COO/CFO misled both the MPM Board of Directors and Milwaukee County officials.**

In fact, there are indications that the former COO/CFO misled both the MPM Board of Directors and Milwaukee County officials:

- At the February 19, 2004 Board meeting, in presenting a financial overview of FY2003, the COO/CFO informed Board members that "Retail exceeded \$2 million for the first time." No mention was made of the fact that MPM had **lost** \$230,000 on retail sales operations in FY2003.



- At the January 28, 2005 meeting of the Endowment Committee, the COO/CFO failed to point out an error in material provided to Committee members that indicated the Endowment Fund had a balance of \$6.4 million. That balance reflected the state of the Endowment Fund more than two years earlier. At the time, the COO/CFO was aware, or should have been aware, that the fund contained only \$2.5 million.
- At a meeting on February 24, 2005, the COO/CFO stated unequivocally to three County staff reviewing the proposed lease and management agreement that the museum's pension obligation, which it had requested be converted to a County obligation for complex accounting reasons, was "fully funded." In fact, the pension obligation as of fiscal year-end 2004 contained an unfunded liability of \$2.1 million.
- At a meeting on May 10, 2005 with several MPM and County officials, in the aftermath of the public disclosure of MPM's financial problems, the former COO/CFO stated that MPM's cash position was "strong throughout negotiations" with the County on the lease and management agreement, even though the museum had a payroll overdraft on March 10th. At this same meeting, MPM's CEO did not disagree with the COO/CFO's assertions.

It is clear, as noted earlier in this report, that MPM's financial condition prior to the March 17, 2005 County Board vote, was dire. This condition was known, in at least a general sense, to MPM's Board members, managers, bankers, auditors and attorneys. During the week before the County Board was scheduled to vote on the new agreement, MPM's Executive Committee was actively engaged in a process of figuring out what had caused the serious problems

**We believe that the failure to publicly disclose MPM's condition prior to County Board adoption of the new agreement was a violation of the public trust.**

We believe that the failure to publicly disclose MPM's condition prior to County Board adoption of the new agreement was a violation of the public trust. If Milwaukee County is to go forward with a new agreement, adoption of recommendations presented in this report will be necessary to ensure that trust is restored.

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## Section 6: Conclusions and Recommendations

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**Ultimate responsibility for MPM rests with its Board of Directors.**

There has been much interest in determining the party or parties responsible for MPM's current financial problems. Ultimate responsibility for MPM rests with its Board of Directors. Day-to-day administration is clearly the responsibility of the CEO. In this case, the Board also placed significant reliance on the COO/CFO. The Board had a high enough degree of confidence in the COO/CFO that candidates for the CEO position were informed that the position of COO was to be part of the management structure. The job description for this position also included a direct reporting line to both the CEO and the Board.

**A situation emerged where the Board did not pick up on periodic assertions of financial difficulty.**

The newly-hired CEO had never worked in a financially challenging environment, and his only previous administrative job had been at a museum with a significant endowment. At his job interview, he disclosed his inexperience in financial matters. MPM's Board did not see this as a problem. Their faith in the COO/CFO was at such a level that he had been seriously considered for the CEO position. Further, the COO/CFO had been asked by the CEO to have all Board communication done through the CEO. Consequently, a situation emerged where the Board did not pick up on periodic assertions of financial difficulty. The CEO did not believe that the situation was as severe as it was, and the COO/CFO, who knew the severity of the problems, did not go directly to the Board with his concerns.

According to the COO/CFO, he was instructed to communicate with the MPM Board through the CEO. According to the CEO, the COO/CFO was free to present any information that he believed was appropriate to the Board and its committees. The CEO could only recall one instance of editing a presentation (to remove negative comments directed toward a staff person). It is especially disturbing that the COO/CFO did not, in clear and

unambiguous terms, communicate to the MPM Board the steadily declining, and ultimately dire, financial condition of MPM.

**It is a matter of dispute whether the severity of MPM's financial situation was clearly communicated by the COO/CFO to the CEO.**

It is a matter of dispute whether the severity of MPM's financial situation was clearly communicated by the COO/CFO to the CEO. In either event, the COO/CFO knew, or should have known, as early as the March of 2004, when he first 'borrowed' Endowment Fund resources to support museum operations, that MPM was in a seriously deteriorating financial state. Further, the CEO knew, or should have known, the same reality. It was at this time that both these individuals, along with the MPM Board Secretary/Treasurer, signed a security agreement with a creditor bank that committed "...all inventory...all revenues, rents, issues, profits, income, and receipts derived in any fashion from all sources...." as collateral for credit extended. Clearly, these individuals collectively failed to inform Milwaukee County of MPM's fragile condition throughout negotiations for a long-term lease and management agreement.

**A climate of continuous growth was promoted by MPM administrators and embraced by its Board of Directors, but fundraising was inadequate to sustain such ambitious growth.**

Our review indicates that a climate of continuous growth was promoted by MPM administrators and embraced by its Board of Directors, but that fundraising was inadequate to sustain such ambitious growth. The result is an organization that saw its financial position decline from one of relative strength in 2001 to near insolvency in 2005. Restoration of fiscal stability will not be easy nor will it be accomplished quickly.

We recommend that the Milwaukee County Board of Supervisors take immediate action to ensure that MPM undertake the following:

1. *Obtain the final 2004 independent audit of MPM's financial statements as soon as possible and require that future audits are provided to Milwaukee County within 180 days of the fiscal year-end.*
2. *File annual budgets, audits and quarterly financial statements with both the Milwaukee County Department of*

*Audit and the Department of Administrative Services. Quarterly financial statements should be filed within 15 days after completion of the quarter in a form acceptable to the County.*

- 3. Include, in MPM's annual contract with an independent audit firm, the requirement that the firm cooperate with requests from the Milwaukee County Department of Audit for information and records related to MPM audits.*
- 4. Revise policies and procedures to ensure proper checks and balances to prevent the improper use of restricted funds. This would include establishing specific parameters for access to Friends of the Museum and Endowment Fund assets, as well as a dual authorization requirement on all appropriate transactions.*
- 5. Assess the MPM Board size, structure and procedures with the goal of enhancing administrative oversight capabilities.*
- 6. Establish a monthly or quarterly meeting cycle of the MPM Audit and Finance Committee.*
- 7. Review for approval all MPM mid-year budget modifications beyond a specified threshold.*
- 8. Ensure that public meetings contain enhanced detail on the reason for invoking closed sessions.*
- 9. Review the criteria applied in hiring a Chief Executive Officer to ensure candidates have a well-rounded administrative experience, including appropriate financial acumen.*
- 10. Separate the duties of Chief Operating Officer and Chief Financial Officer.*
- 11. Discontinue use of employee separation agreement that may hinder a candid, public discussion of key activities of MPM.*
- 12. Reduce standard buy-out provisions contained in standard administrator contracts from one year to a period that provides for more immediate relief in times of financial stress, such as 90 days.*

We further recommend that:

13. *Milwaukee County reevaluate due diligence procedures to ensure that all potential impacts are assessed prior to entering into ventures with private entities.*

*One alternative that should be considered is the retention of an outside firm whenever time limits or the need for special expertise warrant. This will require an additional expense. Another enhancement would be to include, in future agreements, an 'out' clause that gives Milwaukee County the sole discretion to withdraw from a venture if full disclosure has not been made.*

## Audit Scope

The objective of this audit was to identify and analyze the factors leading to the sudden disclosure of severe financial problems at the Milwaukee Public Museum, Inc. Due to urgent interest on the part of MPM financial backers and Milwaukee County decision makers, we have issued this interim report, with a final report anticipated later this year.

The audit was conducted under standards set forth in the United States Government Accountability Office *Government Auditing Standards (2003 Revision)*, with the exception of the standard related to periodic peer review. Limited resources have resulted in a temporary postponement of the Milwaukee County Department of Audit's procurement of a peer review within the required three-year cycle. However, because the department's internal policies and procedures are established in accordance with Government Auditing Standards, and because this audit was performed in compliance with those policies and procedures, the absence of a peer review did not affect the results of this audit.

We limited our review to the areas specified in this Scope Section. During the course of the audit, we:

- Obtained and examined MPM's audited consolidated financial statements for the years 1999 through 2003 and unaudited financial statements for 2004, as well as other key financial supporting schedules.
- Obtained and reviewed available MPM's Board of Directors meeting minutes and attachments, as well as Finance and Audit Committee minutes and attachments, for the period 1999 to date.
- Obtained and reviewed available MPM's Executive Committee minutes and attachments, as well as Endowment Committee minutes and attachments, for the period 2001 to date.
- Obtained and reviewed MPM's Endowment Fund's Statement of Investment Objectives, Policies and Guidelines, as well as its Spending Policy.
- Obtained and reviewed MPM's 21<sup>st</sup> Century Capital Campaign literature and campaign contribution results.
- Interviewed MPM's former CEO, former COO/CFO, interim CFO, former Controller, a number of members of the MPM Board of Directors, as well as other key financial and administrative staff.

2005  
**Board of Directors**  
**MILWAUKEE PUBLIC MUSEUM**

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**Chairman:** David G. Meissner

**Chair Elect:** Kenneth A. Kerznar

**Vice Chairman:** V. Ross Read III

**Secretary/Treasurer:** Edwin P. Wiley

**Asst. Secretary/Asst. Treasurer:** Charles I. Henderson

**President:** Michael D. Stafford, Ph.D.

**RICHARD E. BEIGHTOL**

President, National Worksite Benefits (Retired)

**KATHRYN MURPHY BURKE**

Community Volunteer

**ANGELA COLBERT**

President, Production Stamping Corp.

**SHARON COOK**

Director, Office of Intergovernmental Relations

**MICHELLE CROCKETT**

V.P. Community Affairs, Genesis Behavioral Services

**LYNNE De BRUIN**

Milwaukee County Supervisor

**MARGARET A. FARROW**

Former Lieutenant Governor

**THOMAS L. FRENN**

Attorney at Law

**MARK F. FURLONG**

President, Marshall & Ilsley Bank

**CHARLES T. GORHAM**

President, Gorham, Inc.

**CHARLES I. HENDERSON**

Attorney, Davis & Kuelthau

**KENNETH A. KERZNAR**

Managing Director, J.P. Morgan Securities Inc.

**DANA M. LACH**

Attorney, Foley & Lardner

**PATRICIA BRASH MCKEITHAN**

Vice President, Miller Brewing (Retired)

**DAVID G. MEISSNER**

Executive Director, Public Policy Forum (Retired)

**ROSE MARY MULLER**

Community Volunteer

**GWEN PLUNKETT**

Community Volunteer

**GERARD A. RANDALL, JR.**

Executive Director, Private Industry Council

**V. ROSS READ III**

President & Chairman, Clement Finance & Leasing, Inc.

**KIP RITCHIE**

Community Volunteer

**JOHN E. SCHLIFSKE**

Senior Vice President, Northwestern Mutual Life

**GERALD STEIN**

Chief Executive Officer, Zilber Ltd.

**RICHARD WEISS**

Former Partner, Computer Firm

**ESSIE WHITELAW**

Sr. Vice President, Wisconsin Physician's Service

**EDWIN P. WILEY**

Attorney/Partner, Foley & Lardner

**MICHAEL D. STAFFORD, PH.D.**

President/CEO, Milwaukee Public Museum

**SUSAN FRONK (EX-OFFICIO)**

Friends of the Museum Board President

5/23/2005

# Milwaukee Public Museum

## Board Committees

### February 2005

#### Executive Committee

Meissner, David G. – Chairman  
 Kerznar, Kenneth A. – Chairman  
 Elect; Chair, Audit &  
 Finance; Chair,  
 Endowment  
 V. Ross Read, III – Vice Chair;  
 Chair, Nominating  
 Wiley, Edwin P. – Secretary/  
 Treasurer  
 Henderson, Charles – Asst.  
 Secy/Asst Treasurer;  
 Chair, Human Resources  
 Stafford, Michael D. – President  
 McKeithan, Patricia B. – Past  
 Chair  
 Beightol, Richard E.  
 Burke, Kathryn Murphy – Chair,  
 Education Programming  
 Frenn, Thomas L. – Chair, Govt  
 Affairs  
 Schlifske, John E. – Chair,  
 Development  
 Stein, Gerald  
 Fronk, Susan – President, FOM  
 Board  
*Staff: A Barker, J. Bass, A.  
 Chionchio, T. Gaouette,  
 J. Krivitz, P. Sherman-  
 Cisler, K. Spahn, A.  
 Young*

#### Audit & Finance Committee

Kerznar, Kenneth A. – Chairman  
 Furlong, Mark F.  
 Henderson, Charles  
 Lach, Dana M.  
 Meissner, David G.  
 Stafford, Michael D.  
*Staff: T. Gaouette*

#### Development Committee

Schlifske, John E. – Chairman  
 Beadell, Anthony (FOM)  
 Burke, Kathryn Murphy  
 Fronk, Susan (FOM)  
 Gorham, Charles (FOM)  
 Graff, Stephen N.  
 Henderson, Charles  
 Lindemann, Jean (FOM)  
 Meissner, David G.  
 Muller, Rose Mary  
 Randall, Gerard  
 Read, V. Ross  
 Ritchie, Kip  
 Rush, Leonard (FOM)  
 Stein, Gerald  
 Wiley, Edwin P.  
 Stafford, Michael D.  
*Staff: K. Spahn*

#### Education Programming Committee

Burke, Kathryn Murphy –  
 Chairman  
 Frenn, Thomas L.  
 Plunkett, Gwen  
 Randall, Gerard A.  
 + 3 outside educators to join  
 Meissner, David G.  
 Stafford, Michael D.  
*Staff: J. Bass*

#### Endowment Committee

Kerznar, Kenneth A. – Chairman  
 Beadell, Anthony B. (FOM)  
 Lindemann, Jean S. (FOM)  
 Meissner, David G.  
 Safford, Michael D.  
*Staff: K. Spahn, T. Gaouette*

#### Human Resources Committee

Henderson, Charles – Chairman  
 Frenn, Thomas L.  
 Meissner, David G.  
 Weiss, Richard  
 Whitelaw, Essie  
 Wiley, Edwin P.  
 Stafford, Michael D.  
*Staff: T. Gaouette, P. Sherman-  
 Cisler*

#### Government Affairs Committee

Frenn, Thomas L. – Chairman  
 Cook, Sharon  
 De Bruin, Lynne  
 Farrow, Margaret A.  
 Muller, Rose Mary  
 Randall, Gerard A.  
 Ritchie, Kip  
 Stein, Gerald  
 Meissner, David G.  
 Stafford, Michael D.  
*Staff: J. Krivitz*

#### Nominating Committee

Read, Ross – Chairman  
 Henderson, Charles  
 Jennings, Susan  
 Joerres, Sarah  
 Whitelaw, Essie  
 Wiley, Edwin P.  
 Meissner, David G.  
 Stafford, Michael D.  
*Staff: K. Span*



## MPM Board Expirations

The expiration date is the MPM Annual Meeting date in the year following the year noted below.

(year appointed/elected to board in parentheses)

### Board Elected:

#### 2005

Murph Burke (2002)  
Mark Furlong (2002)  
Charles T. Gorham (2005)  
Chuck Henderson (2002)  
Ross Read (1997)  
Ted Wiley (1992)

#### 2006

Dick Beightol (1998)  
Margaret Farrow (2004)  
Kip Ritchie (2002)  
Gwen Plunkett (2004)  
Jerry Stein (1992)  
*-open position-*

#### 2007

Angela Colbert (2005)  
Ken Kerznar (1992-1999)(2003)  
Patti McKeithan (1995)  
David Meissner (1992)  
John Schlifske (2003)  
Dick Weiss (2000)

### County Appointed:

#### 2005

Gerard Randall (H) (1993)  
Essie Whitelaw (W) (2002)  
Dana M. Lach (W) (2005)

#### 2006

Sup. Lynne De Bruin (H) (2004)  
Sharon Cook (W) (2004)  
*-\*open position – (W)*

#### 2007

Michelle Crockett (H) (2004)  
Tom Frenn (W) (1992)  
Rose Mary Muller (H) (2003)

(H) = appointed by Supervisor Holloway  
(W) = appointed by County Executive Walker

5/23/2005

<b>Procedure</b>	<b>REVISION DATE</b>	<b>CHAPTER TITLE</b>	<b>CHAPTER NO.</b>
ADMINISTRATIVE MANUAL MILWAUKEE COUNTY	04-06-05	Financial & Management Accounting	7
	<b>ORIG ISSUE DATE</b>	<b>SECTION TITLE</b>	<b>SECTION NO.</b>
	12-05-01	Due Diligence	7.92

7.92 DUE DILIGENCE

- (1) **PURPOSE.** The purpose of this section is to identify due diligence procedures to be undertaken prior to entering into ventures with other entities.
- (2) **POLICY.** The Milwaukee County Board of Supervisors authorized and directed the development of administrative procedures for due diligence to be utilized by Milwaukee County before entering into business ventures with outside entities (Resolution 00-460(a)(b)).
- (3) **DEFINITIONS.** The meaning of certain terms used in this section is as follows:
  - (a) Due Diligence. A systematic, formal review of financial and business risks associated with ventures with non-county entities.
  - (b) Non-County Entities. Any agency, business, group or corporation including both private sector proprietary and nonproprietary entities and governmental entities.
  - (c) Ventures. For purposes of this section, ventures shall be defined as any agreement involving a shared responsibility regarding management, development, financing, expenditure or revenue sharing for programs, services or facilities. This includes, for example, revenue based leases but does not include flat fee property rentals. Further, this section shall apply only to ventures where potential total expenditures or revenues are equal to or greater than \$100,000.
- (4) **RESPONSIBILITY.** Any Milwaukee County agency considering a venture with a Non-County entity is responsible for ensuring that all relevant provisions of this section are addressed.
- (5) **BONDING.** Adopted County Board policy states that in any future public/private partnership agreements or contracts, wherein the County issues bonds for the construction of a facility and there is a multi-year schedule for repayment of the bonds through a rental agreement with a third party, that the agreement or contract contain provisions for the repayment to coincide with or commence prior to the time of the due date for each payment on the outstanding bonds. In those contracts where such a condition would not be feasible or where there is deemed a “worthy community purpose” wherein the County decides to “underwrite” a given policy by not requiring payments to retire debt on bonds, any alternative proposal must be brought back to the County Board for review and approval by the County Board and County Executive.  
  
For purpose of this section, this policy also applies to ventures with governmental agencies.
- (6) **CHECKLIST.** Prior to recommending any venture for consideration, responsible County agencies shall ensure that any of the following applicable factors have been identified:
  - Letter of full disclosure and cooperation.
  - Cash flow projections for the venture.
  - Operating budget impact.
  - Debt management responsibilities, schedules and procedures.
  - Legal liability for all priorities.
  - Financial reporting systems and controls.

<b>Procedure</b> ADMINISTRATIVE MANUAL MILWAUKEE COUNTY	<b>REVISION DATE</b> 04-06-05	<b>CHAPTER TITLE</b> Financial & Management Accounting	<b>CHAPTER NO.</b> 7
	<b>ORIG ISSUE DATE</b> 12-05-01	<b>SECTION TITLE</b> Due Diligence	<b>SECTION NO.</b> 7.92

- Right-to-audit provisions.
- Project feasibility studies and market analysis.
- Key factors for success/failure of the venture.
- Governance structure and procedures.
- Public policy impacts (e.g. Affirmative Action. Disadvantaged Business).
- Employee/labor relations impacts (including benefits).
- Environmental concerns.
- Tax consequences.
- Capital management (e.g. maintenance).
- Conflicts of interest/ethics.
- Performance measurements.
- Organizational Chart & Mission Statement.
- Name of lending institution or bank to determine single or combined reporting.

Each relevant item noted above should be included in the description of the proposal which is submitted for approval by the County Executive and County Board.

**Milwaukee Public  
Museum**

June 9, 2005

Mr. Jerome J. Heer, Director of Audits  
Department of Audit  
Milwaukee County-City Campus  
2711 W. Wells St., 9<sup>th</sup> Floor  
Milwaukee, WI 53208

Dear Mr. Heer:

On behalf of the Board of Directors of the Milwaukee Public Museum, I want to thank you and your staff for the opportunity to respond to the draft preliminary audit of MPM and its current financial difficulties. As we have said before, we welcomed the scrutiny of your department. It has a strong reputation for honesty, impartiality and fairness. My reading of this report and that of other key members of our board reaffirmed that opinion. We have no basic disagreements with your preliminary findings and conclusions.

Because of the time constraints and confidentiality associated with your request for a speedy reply to your report, not all the people who should see the report have had that opportunity. Further, a number of us have not been able to really take a "second read" of the document. The result is that many of our comments are of a general nature, pointing to where we believe there may be a factual error or omission or a misunderstanding of an action, but where we have not had time to track down the exact answer. I hope that we can give you a more comprehensive and detailed response in the very near future.

The following are our initial comments:

**1. Page 1, first paragraph under MPM Recent Financial Condition: "These same financial statements show MPM owes its Endowment Fund \$4,221,274."**

Response: The Endowment Fund is made up of several kinds of funds including Unrestricted Funds, Temporarily Restricted Funds and Permanently Restricted Funds. Funds that were unrestricted or temporarily restricted could legally be withdrawn and spent for the purposes for which they were given to the museum. We have not had time to determine those proportions, but we believe that the amount "owed," those funds that were permanently restricted, is less than the figure stated in the report.

**2. Page 1, first paragraph under MPM Recent Financial Condition: “The firm projected that, on an annualized basis, and excluding restricted gifts, proceeds from special exhibits and depreciation, MPM is losing \$7.2 million from normal operations.”**

Response: That number represents Starshak’s estimate of what MPM would lose if nothing were done and Starshak’s recommendations were not implemented. Changes have been made and more changes are planned that should reduce those amounts.

**3. Page 2, second paragraph under Administrative Structure and Responsibility to Inform: “This authority, [granted to one person, the CFO] which included the ability to authorize the sale and disbursement of FOM and Endowment Fund assets, was granted by Board action in April 2002, without the benefit of any approval.” See also page 16.**

Response: Our search of the MPM records suggests that this statement must refer to actions of the MPM Board on April 18, 2002, in accordance with recommendations of the Finance and Audit Committee, approving a standard custodial arrangement with Marshall & Ilsley Trust Company NA, for assets of the MPM Endowment Fund. This action authorized the CFO to identify MPM employees to give directions to the Custodian relating to changes in the investments of the Fund and normal distributions. There was no authorization given for the invasion of the Endowment Fund for general operating purposes.

**4. Page 2, second paragraph under Administrative Structure and Responsibility to Inform: “As of April 30, 2005, the internal financial statements show the Endowment Fund is virtually depleted with a balance of approximately \$340,000.”**

Response: On April 30, the Endowment Fund was \$733,000. In the first week in May, \$250,000 was borrowed from the fund.

**5. Page 2, under Separation Agreement: “We believe that both the one-year payout clause and the restriction on discussion of any facts related to separation are inappropriate for an organization entrusted with public funds and the operation of a public facility and we question the motivation for such self serving clauses.”**

Response: Most of the amount paid the CFO upon termination was legally due him under his contract for accumulated vacation and personal days. The nondisparagement clause was meant to retain a civil relationship with the former CFO and his cooperation with his replacement.

**6. Pages 9 and 14, “MPM owes its Endowment Fund \$ 4,221,274.**

Response: See points 1 and 4.

**7. Page 16, second last paragraph: According to an Executive Committee member, the most recent CEO, during the first year had suggested aggregating funds more clearly and moving away from the COO/CFO structure. The CEO’s suggestions were rejected.**

Response: In closed session the CEO reported that he intended to restructure the COO/CFO's responsibilities and that the CFO intended on leaving MPM in August 2005. The restructuring of responsibilities and aggregating funds more clearly was welcomed by all board members and was not challenged or rejected by any board member. However, one or two board members suggested the COO title not be changed because of the anticipated departure of the COO and his then perceived value to the institution.

**8. Page 26, second full paragraph: "While it may be appropriate to pool funds for the purpose of portfolio management, a detailed accounting of the separate fund balances is essential to ensure accountability to donors."**

Response: We believe that a review of MPM financial statements will show separate and detailed accounts for various Restricted and Endowment Funds notwithstanding the commingling of the investments.

**9. Page 30, second full paragraph: "the museum's pension obligation . . . was fully funded. In fact the pension obligation as of fiscal year-end 2004 contained an unfunded liability of \$2.1 million."**

Response: We think this is misleading because the so-called unfunded liability is calculated on a continuing firm basis, i.e., it represents a calculation of the potential future pension liability if MPM were to continue operating indefinitely on its current basis, may be as much as \$2.5 million. MPM's current obligation, if it were to discontinue operations, appears close to funded by a separate bank account, which is not reflected in the assets of MPM under FASB accounting standards. The bank account total is approximately \$2.1 million.

While this might be an incomplete compilation of comments, we hope that they will be helpful. We would be happy to discuss any of them with you at your convenience.

Sincerely,

David G. Meissner  
Chairman